

Service Mortgage Customers with Resilience Insight:

Using the FICO® Resilience Index



Mortgage servicers have to wrestle with very difficult issues, particularly when they have to manage risks they can't see. It is hard for servicers to tell if borrowers are going to default and, when loans become delinquent, how borrowers will respond to their situation. It can sometimes feel like the loans they thought would be fine end up presenting the biggest challenges.

FICO – developers of the FICO® Score – introduced a new tool designed to give servicers new and powerful insights into their borrowers: the FICO® Resilience Index.

When a borrower defaults, both the borrower and the servicer must navigate numerous hurdles. For the servicer, a formerly profitable loan starts to generate losses. The delinquency obligates a servicer to hire more people, advance missed borrower payments, and bear the cost of hiring the service providers every servicer needs to manage the loan. According to the MBA's Servicing Operations Study, in 2019, the cost of servicing a delinquent loan (\$1,960) was more than 13 times the cost of servicing a performing one (\$147). At the same time, the loan stops generating servicing revenue. Servicers do not earn their servicing fee, float income, or ancillary fees.

Servicers also encounter potential regulatory and reputational risk. Delinquency is stressful for borrowers and that stress tends to generate more borrower complaints regardless of how well a servicer performs its job. Borrower

For consumers with near-prime and subprime FICO® Scores, FICO research has found that consumer-level resilience as measured by the FICO® Resilience Index is predictive of a consumer's recovery from periods of economic stress.

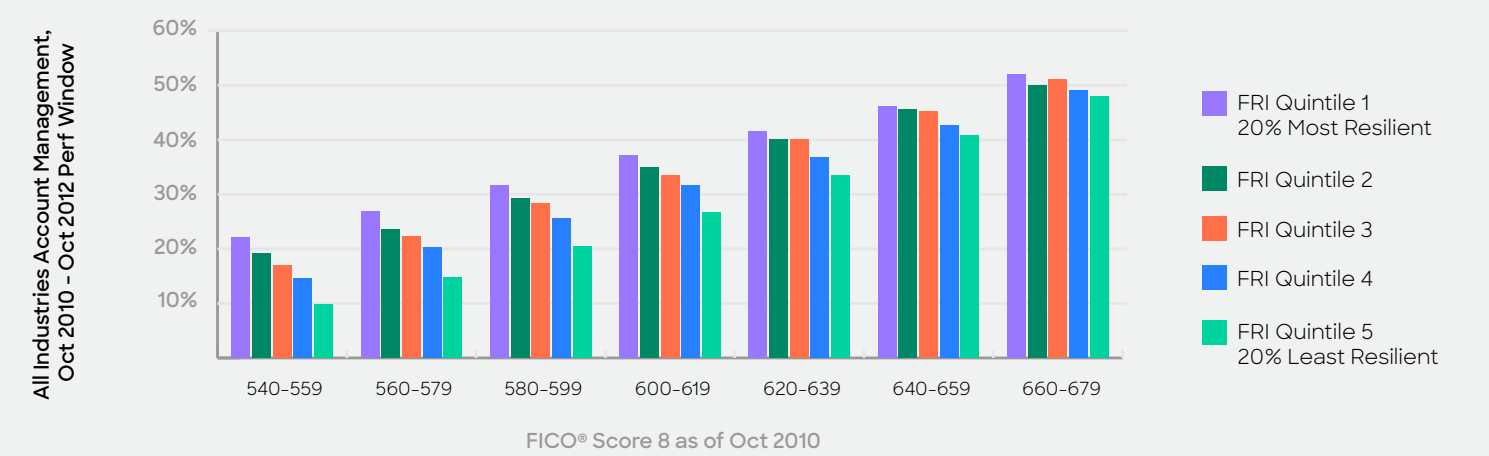
complaints, in turn, can lead to regulatory scrutiny, including exams, remediation work and, in a worst-case scenario, enforcement actions. The CFPB uses its complaints database to help it decide which financial firms to examine and which practices it should investigate. The regulatory examination process can generate negative publicity and even enforcement actions. In the process, a servicer's reputation and brand can take a substantial hit.

Finally, delinquency creates investor risk for servicers. In addition to incurring scrutiny from a government-sponsored enterprise or the Federal Housing Admin-

istration (FHA), a servicer may be subject to penalties for not meeting FHA foreclosure timelines. The servicer may also not be able to recover all of its expenses.

FICO® Resilience Index is designed – as its name suggests – to estimate how well a borrower will respond to a financial “shock.” A borrower's FICO® Score is designed to predict their likelihood of default based on their past credit performance, e.g., how well they did at paying bills. FICO Resilience Index, on the other hand, is built to capture the incremental risk of consumers defaulting on their credit due to economic stress. The stress may arise from a macroeconomic downturn that places financial stress on a significant portion of the general population, or it may be caused by more localized or individual circumstances. For consumers with near-prime and subprime FICO Scores, FICO research has found that consumer-level resilience as measured by FICO Resilience Index is predictive of a consumer's recovery from periods of economic stress, with “recovery” demonstrated by successfully transitioning from delinquencies on one or more credit obligations to a state of no delinquencies. Maintaining and updating FICO Resilience Index values on accountholders at the same cadence as FICO Score updates on a servicer's portfolio can allow the servicer to tailor and prioritize early-stage outreach efforts according to the current resilience levels of its customers.

FIGURE 1 : % of Consumers Who Were Delinquent as of October 2010 and Cured by October 2012.

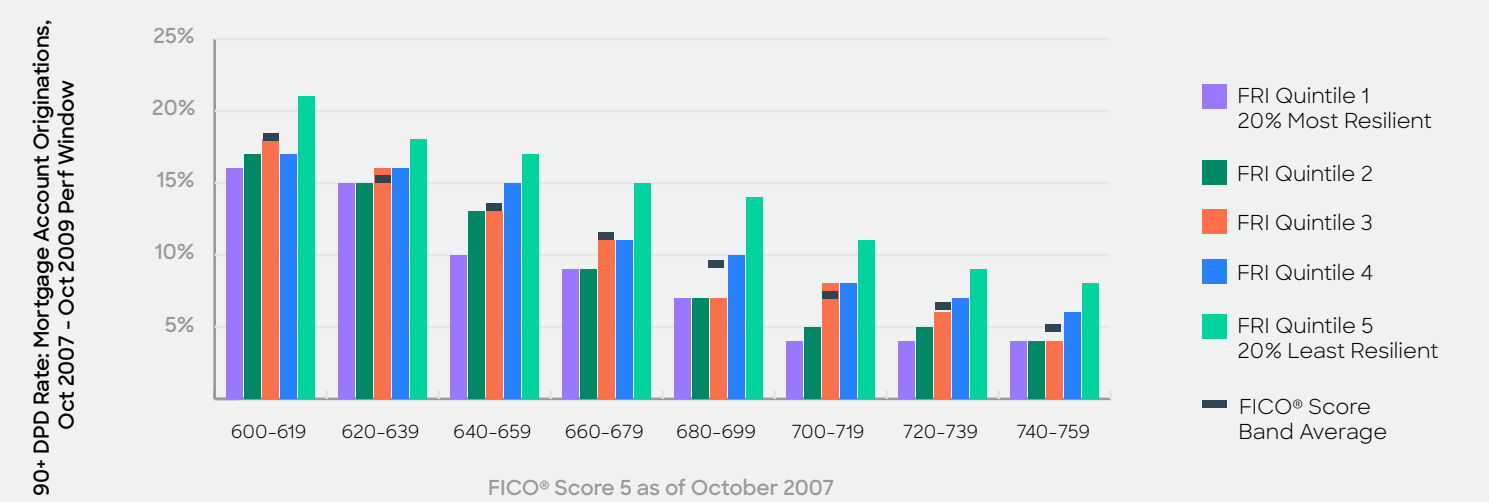


FICO® Resilience Index generates a borrower FICO Resilience Index value between 1 and 99. Highly resilient borrowers get a lower value (e.g., a FICO Resilience Index of 30), less resilient borrowers a higher one (e.g., a FICO Resilience Index of 70).

FICO® Resilience Index is designed to be used with a borrower's FICO® Score and it reveals significant differences between borrowers with the same FICO Score as well as interesting similarities between borrowers with different FICO Scores. For example, a very resilient borrower with a 680 FICO Score may be significantly less

likely to default in the event of a recession than another borrower with the same FICO Score but who is much less resilient. In addition, a borrower with a 640 FICO Score but very high resilience may be less likely to default if their financial situation changes than a borrower with a 680 FICO Score but very low resilience.

FIGURE 2 : FICO® Resilience Index Provides Additional Rank Ordering During Stressed Economy For Mortgage Originations.



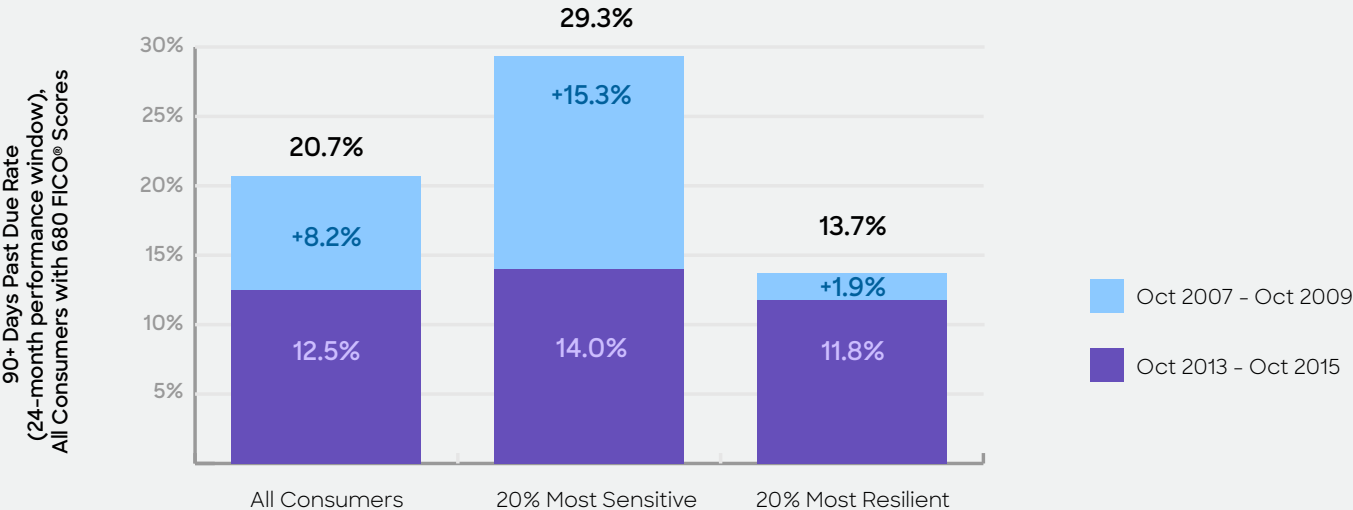
Borrowers in the strongest resilience quintile outperformed their low resilience FICO® Score peers by a factor of more than four.

Borrower resilience tends to be associated with how a borrower uses credit. Highly resilient borrowers tend to have fewer active credit accounts, lower total loan balances, more experience managing credit, and fewer recently opened trade lines.

FICO developed FICO® Resilience Index by, among other things, comparing the credit performance of borrowers

with similar FICO® Scores across normal and stressed macroeconomic scenarios. Using credit bureau data, FICO examined how borrowers with different FICO Resilience Index values but the same FICO Score bands performed in response to the economic downturn between October 2007 and October 2009 and to normal economic conditions between October 2013 and October 2015. The results are striking.

FIGURE 3 : For the most sensitive consumers, the 90+ DPD rate during the Great Recession was more than double the rate during a normal economy.



Mortgage professionals were not surprised by the impact of the Great Recession on delinquency rates. As Figure 3 shows, however, there was an effect no one could see until now. In any given FICO® Score band, delinquencies

were concentrated among borrowers in the quintile with the lowest resilience. Borrowers in the strongest resilience quintile outperformed their low resilience FICO Score peers by a factor of **more than four**.

How Can Servicers Benefit from FICO® Resilience Index?

Use of FICO® Resilience Index can offer servicers an important insight into their borrowers: latent risk of default. Before FICO Resilience Index, a borrower with a

low FICO® Score might, draw a servicer’s attention away from a borrower with a high FICO Score but very low resilience. Without FICO Resilience Index, servicers miss latent risks that threaten to change the servicers’ financial and risk profile for the worse.

With FICO® Resilience Index, a servicer can take several steps to manage default risk. The most obvious one is early intervention. Even within investor guide-lines, servicers have a choice: call the day after a missed payment or wait until the borrower has had a reasonable chance to cure. For resilient borrowers, even if they have lower FICO® Scores, waiting might

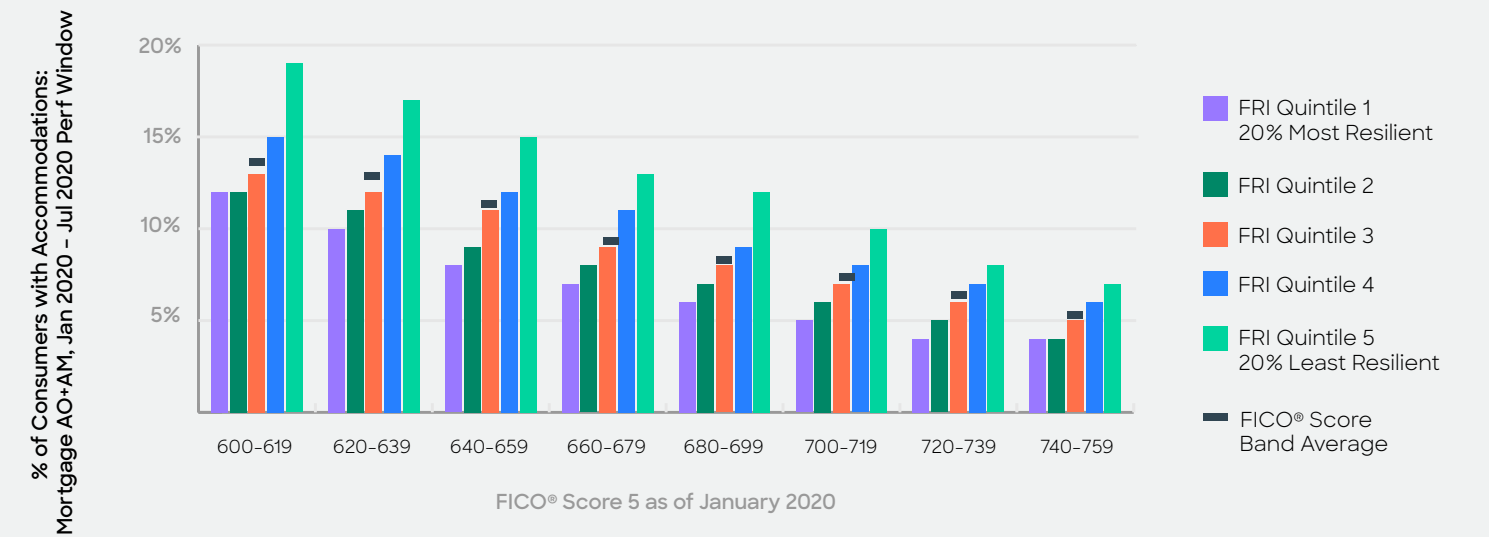
make sense. It spares precious resources for borrowers who really need help. But for low resilience borrowers, regardless of their FICO Scores, there is a compelling business case for calling sooner rather than later. An early intervention may head off a delinquency or it may facilitate a modification in response to a risk of imminent default. Servicers might also use FICO Resilience Index values (together with corresponding FICO Scores) to manage their staffing.

Servicers with a large population of highly resilient borrowers will likely need less staff than servicers with less resilient borrowers. Moreover, servicers that

anticipate a macroeconomic contraction can calibrate their staffing plans more precisely based on the resilience of their borrowers.

Servicers could also elect to use FRI to assess the terms of any acquisition of new servicing rights. Portfolios with significant numbers of low resilience borrowers are likely to cost more to service than ones with higher resilience borrowers. Under the circumstances, a servicer may decide, for example, that they want to carry less responsibility for advancing in the former case than in the latter.

FIGURE 4 : FICO® Resilience Index Validation on Mortgage Accommodations. Most resilient groups are about half as likely to have payment accommodation(s) as least resilient quintile in this band.



FICO's introduction of FICO® Resilience Index is timely for mortgage servicers. The COVID-19 pandemic and the federal government's relief measures have created a tremendous amount of uncertainty for servicers. Mortgage professionals anticipate a lot of complicated work when the various forbearance programs and moratoria expire. Using FICO Resilience Index can make that work easier — for example, by predicting the frequency with which borrowers would need a forbearance.

Servicers can also use FICO® Resilience Index to help better anticipate the assistance borrowers will need when they no

longer get government assistance. Highly resilient borrowers may be more likely to restart their mortgage payments but require a deferral of their arrearages; low resilient borrowers, on the other hand, may require a modification that lowers their monthly payment.

Mortgage servicers might even consider developing a program that takes advantage of low interest rates to help highly resilient borrowers who cannot reinstate their loans by offering them a non-agency refinance that lowers their monthly payment.



Whatever they do, servicers will
need FICO® Resilience Index.



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